

Qwest Faces Questions

By Scott Moritz
Senior Writer

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Qwest's (Q) solid third quarter wasn't enough to keep the bulls happy.

The Denver phone giant posted an adjusted profit of 9 cents a share on \$3.49 billion in sales. Those numbers beat bottom-line expectations, but the top line was a hair light.

Lacking a blowout performance, investors focused on some of the weak spots in the financial report. Two areas stood out: a falling telephone line count and slightly thinner cash flow.

In an interview Tuesday, CEO Dick Notebaert emphasized the company's progress and said the weak spots should be put in perspective.

"Our access line loss is best in class," said Notebaert, referring to the 6% line shrinkage rate as it compares with the 6%-plus industry norm. And, says Notebaert, "we blew it out on margin expansion."

Qwest has had nine consecutive quarters of gross margin expansion, as deep cost cuts help the company keep more revenue.

But with Qwest shares up 120% over the past year, fans on Wall Street needed a little more candy corn to stay sweet on the stock.

Instead, there was a little decay in investor confidence after the company reported lighter-than-expected free cash flow. The problem is that the company has a full-year goal to reach a cash-flow target somewhere between \$1.35 billion and \$1.5 billion. As of the third quarter, it has booked \$803 million.

The company has one more quarter to get about \$600 million in cash flow and hit its mark. Some observers have their doubts.

But CEO Notebaert says he's confident the company will hit its free cash flow target.

Notebaert says the free cash flow pattern will be the same as last year, when the company saw a big bump up in the fourth quarter. One of the big reasons the Qwest chief is so confident is that the interest-payment calendar is in his favor. Unlike the first and third quarters, Qwest will not have to pay \$300 million in loan costs in the fourth quarter.

So a little \$300 million head start and what Notebaert calls "operational success" in the fourth quarter will help cinch the cash-flow target.

Meanwhile, investors seem to be more interested in trading in their Qwest winnings instead of hanging around to see if predictions are accurate.

Qwest shares fell 39 cents to \$8.62 in midday trading Tuesday.